

Message Text

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ACTION SS-30

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P 112212Z JAN 74
FM AMEMBASSY TEL AVIV
TO SECSTATE WASHDC PRIORITY 1168

C O N F I D E N T I A L SECTION 1 OF 2 TEL AVIV 0230

EXDIS

E O 11652: GDS
TAGS: EAID, IS
SUBJECT: ISRAEL'S AID REQUEST FOR FY 1975

REF: A. STATE 3184
B. STATE 240748
C. TEL AVIV 9274

1. SUMMARY:. OUR ASSESSMENT OF BALANCE OF PAYMENTS DATA IN
EF A (WHICH SUPERSEDE FAULTY DATA IN REF B), IS THAT IT
EXAGGERATES REQUIREMENTS FOR USG FINANCIAL ASSISTANCE. GOI
ITSELF DOES NOT KNOW WHAT BPO WILL LOOK LIKE IN 1974, LET
ALONG 1975. SEVERAL BASIC ECONOMIC DECISIONS (SIZE OF GOVT
BUDGET, WAGE POLICY, TAXES) ARE HANGING FIRE, DUE TO PRE-
OCCUPATION WITH FORMATION OF NEW CABINET; IT WILL TAKE AT
LEAST SEVERAL MONTHS BEFORE SITUATION CLEARS. ISRAEL'S RE-
QUIREMENTS FOR USG AID DEPEND ESSENTIALLY ON HOW MUCH MILITARY
EQUIPMENT WE SELL TO ISRAEL; WASHINGTON CAN ASSESS THIS BETTER
THEN WE. HOWEVER, IF WE AGREE TO SELL ISRAEL ONLY (SAY)
DOLS 2.2 BILLION IN MILITARY EQUIPMENT, AND PROVIDE DOLS 2.2
BILLION IN EXTRAORDINARY ASSISTANCE TO PAY FOR IT, ENTIRE SO-CALLED
UNCOVERED GAP IN CYS 1974 AND 1975 VANISHES, EVEN BY PADDED
ESTIMATES IN REF A. WITH ADMINISTRATION'S AID BILL OF
DOLS 2.2 BILLION IN HAND, THERE IS NO ECONOMIC REASON TO BE RUSHED
INTO FURTHER DECISIONS ON AID. I URGE THAT WE ACT ON MY
RECOMMENDATION FOR DOLS 1 BILLION GRANT (REF C), WHICH IT IS NOW
CLEAR WAS AMPLY GENEROUS FIRST STEP, WELL BEFORE 120 DAY CREDIT
PERIOD EXPIRES. SINCE PREPARING ABOVE, PRIMIN HAS ASKED
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ME TO SEE FINMIN SAPIR, WHICH I WILL DO AT 5 PM TODAY.
END SUMMARY.

2. WE HAVE DISCUSSED REF A WITH EPHRAIM DAVRATH, ECONOMIC

ADVISER TO FINMIN SAPIR, THE MOST KNOWLEDGEABLE SOURCE OF INFO ON THE ECONOMY. TO HIS EVIDENT RELIEF, DAVRATH ACKNOWLEDGED THAT FIGURES WERE HIS. THEY SUPERSEDE COMPARABLE DATA IN REF B AND SHER PAPER OF NOVEMBER 29, WHICH IS BEST REGARDED AS PREMATURE ATTEMPT TO WALK ON QUICKSAND OF COMING YEAR. (DATA IN REF B WERE SUBSEQUENTLY MUCH MODIFIED BY DAVRATH).

3. AS OUR CONVERSATIONS HERE HAVE MADE PROGRESSIVELY CLEAR, GOI ITSELF DOES NOT YET KNOW WHAT 1974 WILL LOOK LIKE, LET ALONE 1975. MAJOR ECONOMIC DECISIONS ABOUT POLICIES MUST BE TAKEN BEFORE RELIABLE FORECAST CAN BE MADE. HOWEVER, SAPIR IS FULLY ENGAGED HEADING NEGOTIATIONS TO FORM NEW CABINET, AND IN HIS ABSENCE NO ONE CAN MAKE MAJOR DECISIONS. DECISIONS ON WHAT NEW TAXES (IF ANY) WILL BE IMPOSED AND WHEN THEY WILL BE IMPOSED MUST BE MADE; THIS PERTAINS IMMEDIATELY TO LONG-MOOTED VALUE-ADDED TAX AND OTHER INDIRECT TAXES, SINCE DIRECT TAXES (INCLUDING COMPULSORY LOANS) WERE INCREASED SEVERAL MONTHS AGO. SIZE OF GOVT BUDGET FOR COMING YEAR WILL BE SINGLE MOST IMPORTANT INFLUENCE ON ECONOMY, SINCE GOI SPENDS ABOUT 60 PERCENT OF ISRAEL'S GROSS NATIONAL PRODUCT: BUT THIS HAS NOT BEEN DECIDED. NATIONAL WAGE NEGOTIATIONS ARE DUE NOW FOR MOST WORKERS IN ISRAEL, WHICH WILL DETERMINE COST-OF-LIVING (TAX-EXEMPT) ALLOWANCES AND BASIC WAGE COMPENSATION FOR COMING YEAR; GOVERNMENT GUIDELINES ARE NEEDED URGENTLY, AND THEY WILL HAVE LARGE IMPACT ON ECONOMY. IF THIS WEREN'T ENOUGH UNCERTAINTY, SOME ECONOMISTS ARE PREDICTING WORLD-WIDE RECESSION; THIS COULD LOWER PRICES OF ISRAEL'S IMPORTS, BUT ALSO DECREASE EXPORT SALES.

4. RISE IN WORLD PETROLEUM PRICES THREATENS TO AFFECT BPO ADVERSELY, BY INCREASING COST OF PETROLEUM IMPORTS, AS WELL AS TRANSPORTATION COSTS; BUT PERHAPS FUEL PRICE WILL DECLINE BEFORE YEAR IS FAR GONE. VOLUME OF ISRAEL'S EXPORT WILL BE AFFECTED BY LEVEL OF MOBILIZATION, WHICH GOI ECONOMISTS ARE PREDICTING WILL GO DOWN SHARPLY IN NEAR FUTURE; BUT WHAT HAVE MILITARY MEN TO SAY? MOREOVER, DEMAND FOR IMPORTS OF CIVILIAN-CONFIDENTIAL

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TYPE GOODS WILL BE RETARDED BY HIGH-LEVEL MOBILIZATION AS WELL. IN SHORT: GOI CANNOT NOW FORECAST BOP WITH ANY ASSURANCE, AND THIS SITUATION IS UNLIKELY TO CHANGE FOR AT LEAST COUPLE MORE MONTHS.

5. FIGURES IN REF A ARE BEST AVAILABLE FOR TIME BEING, BUT HAVE CONSISTENCY OF JELLO FOR 1974 (IN THAT THEY WOBBLE SOMEWHERE AROUND REALITY), WHILE THOSE FOR 1975 ARE WORTHLESS. COMMENTS WHICH FOLLOW ARE CORRESPONDINGLY MORE GENERAL THAN IN PAST SUCH ANALYSES, AND DEAL ONLY WITH 1974.

6. MAIN FACTOR AFFECTING BOP IN NEXT TWO YEARS WILL BE DEFENSE IMPORTS, AND THIS DEPENDS IN TURN ON HOW MUCH USG AGREES

TO SELL TO ISRAEL. WE NOTE THAT IMPORTS OF DEFENSE GOODS (INCLUDING RAW MATERIALS FOR DEFENSE INDUSTRIES, THE SO-CALLED INDIRECT DEFENSE IMPORTS) WILL AGGREGATE ALMOST DOLS 5 BILLION DURING THREE YEARS 1973-75. GOI PROPOSES PHASING OUR DOLS 2.2 BILLION CREDIT OVER THREE CALENDAR YEARS 1973-74-75 IN AMMOUNTS OF DOLS 800-800-600 MILLION, RESPECTIVELY. AFTER DOING SO, AND ALLOWING FOR ALL OTHER USG ASSISTANCE, REF A FORECASTS THAT THERE WILL STILL BE "UNCOVERED GAPS" IN 1974 AND 1975 BOP AGGREGATING A LITTLE MORE THAN DOLS 1 BILLION. WE ARE STRUCK BY COINCIDENCE OF SIZE OF THIS FIGURE WITH SIMILAR DIFFERENCE BETWEEN DOLS 3.2 BILLION IN DEFENSE GOODS ISRAEL DESIRES BO BUY FROM USG (SEE NOV 29 PAPER), AND ADMINISTRATIONS'S DOLS 2.2 BILLION AID BILL. IF USG ADOPTS SUGGESTION IN DEPUTY SECRETARY CLEMENTS' STATEMENT OF NOV 14 (HE SAID USG MIGHT EVENTUALLY AGREE TO SELL EQUIPMENT OF AGGREGATE VALUE OF "SLIGHTLY IN EXCESS OF DOLS 2 BILLION" OUT OF ISRAEL'S REQUEST "WHICH TOTALS NEARLY DOLS 3 BILLION")-- ENTIRE UNCOVERED GAP VANISHES.

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ACTION SS-30

INFO OCT-01 ISO-00 /031 W
----- 085152
P 112212Z JAN 74
FM AMEMBASSY TEL AVIV
TO SECSTATE WASHDC PRIORITY 1169

C O N F I D E N T I A L SECTION 2 OF 2 TEL AVIV 0230

EXDIS

7. LOOKING MORE CLOSELY INTO MATTER, SHR'S NOV 29 PAPER SEEMS TO BE SAYING THAT DOLS 3.2 BILLION WILL BUY, INTER ALIA, 910 (PRESUMABLY COMBAT) AIRCRAFT. ASIDE FROM FACH THIS WOULD TRIPLE SIZE OF ISRAELI AIR FORCE, AND FURTHER QUESTION WHETHER ISRAEL NEEDS THAT MANY PLANES, IS IT FEASIBLE TO TRANSFER THAT MANY AIRCRAFT TO ISRAEL BY END OF 1975? WE DEFER TO WASHINGTON ON THIS QUESTION, BUT OBSERVE THAT ISRAEL'S "NEEDS" (IN SOME SENSE) FOR USG FINANCIAL ASSISTANCE DEPEND IN FIRST PLACE ON DECISIONS ON SALES OF DEFENSE EQUIPMENT.

8. BOP FORECAST FOR 1974 SHOWS ANTICIPATED RISE OF DOLS 875 MILLION (24 PERCENT) OVER 1973 FOR CIVILIAN IMPORTS. WE THINK THIS IS EXAGGERATED. THERE WAS BIG INCREASE OF OVER 50 PERCENT FOR VALUE OF CIVILIAN IMPORTS IN 1973 OVER 1972, AND FOLLOWING SUCH AN INCREASE WE SHOULD SEE LEVELING OFF. MOREOVER, PEOPLE ARE NOT BUYING AT PRESENT, DUE TO

LOSS OF INCOME FROM MOBILIZATION OF MANY WAGE EARNERS, AND HIGH DEGREE OF UNCERTAINTY AS TO COMING YEAR; THIS REDUCES DEMAND FOR IMPORTS, SINCE NEARLY EVERYTHING PRODUCED IN ISRAEL HAS SUBSTANTIAL IMPORT CONTENT. WE QUESTION ASSUMPTION (REF A, PARA 4D) OF 25 PERCENT INCREASE IN WORLD PRICES, BUT THIS IS DEBATABLE, AND WASHINGTON MAY BE IN BETTER POSITION TO FORECAST WORLD PRICE TRENDS THAN WE.

9. FORECAST SHOWS EXPORTS RISING 22 PERCENT IN 1974 OVER 1973, OF WHICH SOME PART IS ATTRIBUTABLE TO HIGHER
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PRICES. UNLESS THERE IS SIGNIFICANT MEASURE OF DEMOBILIZATION SOON, EXPORT TARGETS MAY BE HIT. THUS, FIGURE MAY BE OPTIMISTIC SIDE, BUT WE ARE NOT IN POSITION TO ANALYZE IT WITHOUT BREAKDOWN, WHICH IS NOT YET AVAILABLE.

10. OVER THE YEARS COLORED PAPERS HAVE CONSISTENTLY UNDERESTIMATED CAPITAL ISRAEL WILL BE ABLE TO RAISE THROUGH ITS OWN MEANS, AND CORRESPONDINGLY OVERESTIMATED ISRAEL'S REQUIREMENTS FOR USG ASSISTANCE: JUDGING BY REFTELS, FORTHCOMING GRAY PAPER WILL BE NO EXCEPTION. REF A FORECASTS THAT DESPITE TOTAL USG ASSISTANCE PROJECTED AT DOLS 1,288 MILLION (COMPRISING USG "REGULAR" LOANS DOLS 398 MILLION, USG "REGULAR" GRANTS DOLS 90 MILLION, AND DOLS 800 MILLION IN EMERGENCY SECURITY ASSISTANCE)-- THERE WILL BE ADVERSE SWING IN BOP OF OVER DOLS 1 BILLION, FROM SURPLUS ON BASIC BALANCE OF DOLS 686 MILLION IN 1973 TO DEFICIT OF DOLS 512 MILLION IN 1974. (THESE FIGURES ASSUME RECEIPT OF DOLS 800 MILLION IN EMERGENCY SECURITY ASSISTANCE IN EACH OF 1973 AND 1974.) ASSUMING ISRAEL RECEIVES THE USG ASSISTANCE PROJECTED IN REF A, WE WOULD EXPECT ISRAEL TO RUN ANOTHER SURPLUS ON BASIS BALANCE. IMPROVEMENT OVER REF A DATA WOULD COME FROM BOTH CAPITAL AND CURRENT ACCOUNTS. ON CAPITAL ACCOUNT WE NOTE SHARP DECLINE FORECAST FOR RECEIPTS FROM TRADITIONAL SOURCES (INSTITUTIONAL AND PERSONAL TRANSFERS, AND BONDS). THERE MAY WELL BE SOME FALLING OFF FROM PEAK EFFORT IN WAR YEAR OF 1973, ESPECIALLY IF THERE IS RECESSION IN U.S. THIS YEAR, BUT THERE IS ALSO TENDENCY FOR TRADITIONAL SOURCES TO MOVE INVERSELY WITH USG AID. ON THE BASIS OF PAST EXPERIENCE, WE ASSUME THAT FIGURES FOR CAPITAL INFLOW CITED IN REF A REPRESENT UNDULY PESSIMISTIC PROJECTION, WHICH WILL BE IMPROVED UPON.

11. IN ANALYZING PINK PAPER A YEAR AGO EMBASSY CONCLUDED (TEL AVIV 0830 JAN 31, 1973): QUOTE UNDER CIRCUMSTANCES DESCRIBED ABOVE, ISRAEL WILL NOT-- FROM STRICTLY ECONOMIC POINT OF VIEW-- REQUIRE AID FROM USG IN FY 1974. END QUOTE. OUR AID DURING YEARS 1972 AND 1973 WENT IN EFFECT TO PUSH UP ISRAEL'S FOREIGN EXCHANGE RESERVES AND

ITS FOREIGN DEBT. WHILE WE CAN ONLY MAKE TENTATIVE ASSESS-
MENT DUE TO CIRCUMSTANCES DETAILED ABOVE, WE BELIEVE THAT
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REF A EXAGGERATES REQUIREMENTS FOR USG AID. IT SEEMS LIKELY
THAT ADMINISTRATION'S DOLS 2.2 BILLION AID BILL WILL MEET ISRAEL'S
LEGITIMATE NEEDS THROUGH 1975. IT IS NOW CLEAR THAT RECOM-
MENDATION FOR DOLS 1 BILLION GRANT IN REF C WAS SUFFICIENTLY
GENEROUS TO TIDE ISRAEL OVER SHORT-TERM FINANCIAL PROBLEM,
UNTIL WE (AND ISRAELIS) ARE IN POSITION TO BETTER
ASSESS SITUATION.

12. WITH ADMINISTRATION'S DOLS 2.2 BILLION AID BILL IN HAND,
I DO NOT BELIEVE THAT THERE IS ANY ECONOMIC REASON TO BE
RUSHED INTO FURTHER DECISIONS ON AID. I URGE THAT WE
ACT ON MY RECOMMENDATION OF DOLS 1 BILLION GRANT, WELL BEFORE
120-DAY CREDIT PERIOD EXPIRES. IF ADDITIONAL STEP IS
DEEMED APPROPRIATE ON POLITICAL GROUNDS, WE COULD ADD
DOLS 500 MILLION ON LOAN TERMS SIMILAR TO MILITARY CREDIT
ASSISTANCE; BUT ECONOMIC CONSIDERATIONS DO NOT REQUIRE
IMMEDIATE DECISION.
KEATING

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